

This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 04 TAIPEI 003734

SIPDIS

SENSITIVE

DOT FOR ASSISTANT SECRETARY KARAN BHATIA

DEPARTMENT FOR EAP/RSP/TC

DEPARTMENT PASS AIT/W

E.O. 12938: N/A

TAGS: [ECON](#) [PREL](#) [FAIR](#) [PGOV](#) [OVIP](#) [TW](#)

SUBJECT: Scenesetter for DOT A/S Bhatia's Trip to Taiwan

REF: A) AIT TAIPEI 3523, B) AIT TAIPEI 3563

Summary

1. (U) The United States' unofficial relations with Taiwan focus on regional security and trade. Taiwan is considering the purchase of USD 18 billion in military equipment from the U.S. Outstanding trade issues include intellectual property rights, pharmaceuticals and telecommunications market access, and rice imports. December 11 legislative elections will determine if President Chen's Democratic Progressive Party will gain control of Taiwan's legislature for the first time. The economy is returning to strong growth after Taiwan's first recession in half a century. Despite the impact of cross-Strait political tensions, the economy increasingly depends on exports to Taiwan's PRC-based manufacturing. The primary concern of Taiwan's aviation industry is the lack of direct air links with the PRC. (End summary.)

U.S.-Taiwan Relations - Security and Trade

2. (U) On January 1, 1979, the United States changed its diplomatic recognition from Taipei to Beijing. In the U.S.-P.R.C. Joint Communiqué that announced the change, the United States recognized the Government of the People's Republic of China as the sole legal government of China and acknowledged the Chinese position that there is but one China. The Joint Communiqué also stated that within this context the people of the United States would maintain cultural, commercial, and other unofficial relations with the people on Taiwan. In April 1979 the Taiwan Relations Act (TRA) created the legal authority for the establishment of the American Institute in Taiwan (AIT), a private nonprofit corporation. U.S. Government visitors to Taiwan are considered AIT consultants while conducting USG business in Taiwan and must travel on a tourist passport. Travel by USG senior officials to Taiwan is carefully controlled and rare; your visit will attract attention.

3. (U) Under the Taiwan Relations Act, the United States is committed to offering military equipment that Taiwan needs to defend itself. The Legislative Yuan is currently considering a USD 18 billion special budget, which will allow Taiwan to purchase diesel submarines, P-3C anti-submarine patrol aircraft, and PAC-III anti-missile batteries. Consideration of the budget bill has been delayed until after the December 11 elections.

4. (SBU) Market access and trade issues are the main concerns in U.S.-Taiwan economic relations. Taiwan joined the WTO in 2002 and committed to reduce barriers to trade in several areas, including telecommunications and government procurement. Many of these commitments remain incomplete. For several years, intellectual property rights have also been a key point of contention. Taiwan has been a center for piracy of optical media and has seen an influx of counterfeit products, including pharmaceuticals and branded goods, from China. However, in the last year, Taiwan has improved enforcement of its intellectual property laws, passed an amended Copyright Law, and proposed legislation to create a data-exclusivity regime for pharmaceuticals. These improvements have led the U.S. Trade Representatives office to open an out-of-cycle review to consider Taiwan's status on the Special 301 Priority Watch List. The U.S. still has concerns about market access for pharmaceuticals and telecommunications service providers. We also continue discussions with Taiwan on its tariff and quota regime for rice imports. On November 29, the U.S. and Taiwan will resume talks under the Trade and Investment Framework Agreement to further progress toward resolving some of these outstanding issues.

Politics - More Divided Government?

15. (U) When Taiwan's President Chen Shui-bian was first elected in 2000, it marked the first transition of political power in Taiwan since World War II and the consolidation of democracy in Taiwan. Chen's independence-leaning Democratic Progressive Party (DPP) has asserted increasing control over the executive branch bureaucracy, which had been dominated for decades by the Kuomintang (KMT). In March 2004, Chen was narrowly reelected with less than 50.1 percent of the popular vote. A controversial shooting incident the day before the election, in which Chen and Vice President Annette Lu were mildly injured, and the KMT candidates' refusal to accept the results of the 2004 election have contributed to a particularly bitter partisan environment.

16. (SBU) Legislative elections scheduled for December 11, 2004, will determine whether Taiwan will have another three years of divided government. The KMT, with its opposition partner the People First Party (PFP), forms the "Pan-Blue" alliance, which controls the Legislative Yuan, Taiwan's main legislative body. The DPP with its "Pan-Green" partner, the strongly pro-independence Taiwan Solidarity Union (TSU), hopes to take control of the legislature for the first time. Many observers predict that neither camp will have a strong majority. Both camps will need to form ad-hoc alliances to move legislation. That could slow passage of needed economic and financial reforms, but it could also discourage legislation that might increase cross-Strait tensions.

Economy - Resurgent Growth

17. (U) Taiwan is the 17th largest economy in the world. For nearly 50 years before 2001, Taiwan experienced rapid economic expansion, low unemployment, and low inflation -- often called "Taiwan's Economic Miracle." In 2001, the economy contracted for the first time since 1952, largely due to fallout from the global high technology industry downturn that reduced demand for exports in the key markets of the U.S., Europe and Japan. After two more years of disappointing growth in 2002 and 2003, the economy has boomed this year with double-digit export growth. Economists predict that Taiwan's economy will once again return to strong growth in 2004, with real GDP growth reaching nearly 6 percent.

18. (U) Exports of information technology and other high-tech goods continue to be one of the main drivers of Taiwan's economy, even as many firms move manufacturing operations to China or Southeast Asia. In the first half of 2004, Taiwan's exports grew 26 percent over the same period last year. Semiconductors have been an especially important component of Taiwan's economic success. Today, flat panel displays are also playing an increasing role. Taiwan's government has plans to continue to stimulate the growth of these high-tech sectors, as well as to develop new technologies such as biotechnology and nanotechnology. Taiwan's government also hopes to diversify Taiwan's economy beyond manufacturing into digital content, logistics, finance and other services.

19. (U) Taiwan's macroeconomic policy has sought to maintain stable exchange rates, low inflation and low interest rates. Taiwan, after China and Japan, has the third largest stock of foreign exchange reserves in the world. It has made progress in strengthening a banking system that was in serious trouble in 2001 and 2002 and improving the supervision of financial institutions. However, the Taiwan government has yet to fully deal with a number of insolvent institutions. Taiwan's eroding tax base, a "no new taxes" pledge, and growing social welfare costs have left the Chen administration with a large budget deficit and limited options to pursue new spending on key economic and defense objectives. The budget crunch will continue unless Taiwan manages to choose between the politically unfeasible options of raising taxes, cutting popular social programs, or running historically high deficits. None of these alternatives will be politically palatable, especially if political power is evenly divided in the Legislative Yuan.

Cross-Strait Tension and Economic Integration

10. (SBU) While strained political relations with Beijing dominate both Taiwan's domestic politics and national security issues, investment in the Mainland and trade across the Strait are increasingly the driving forces in Taiwan's economy. The ruling DPP promised early on in the current election season to keep cross-Strait relations and issues of sovereignty out of the legislative elections. Nevertheless, political rhetoric is again increasingly focused on the government's and the president's approach to cross-Strait relations. The official name of the Republic of China and President Chen's proposal to write a new constitution for Taiwan are also sensitive domestic political issues that threaten to increase cross-Strait tension. Taiwan companies that have supported the DPP have found their activities in

the PRC subject to increased scrutiny.

11. (U) In 2003, China replaced the U.S. as Taiwan's number one trading partner. Exports to the PRC and Hong Kong make up 35 percent of Taiwan's total exports. The PRC accounted for more than 70 percent of Taiwan's outward foreign investment in the first half of 2004. Much of Taiwan's labor-intensive manufacturing has moved to the Mainland, especially in industries like textiles, shoes, toys, furniture, etc. In information technology and other high-tech industries, the manufacture of technology and capital-intensive components has in large measure stayed in Taiwan, while downstream assembly of final products has moved to Mainland China. However, increasingly Taiwan investors are moving the manufacture of upstream high-tech components to the PRC as well. Despite pressure from businesses, the Taiwan government continues to restrict investment in the Mainland for certain categories of high-tech manufacturing. Most of the electronics consumer goods manufactured by Taiwan firms in the PRC are subsequently exported to the U.S., Japan, or Europe. In that sector, Taiwan's economy is not reliant on domestic demand in the PRC. Other Taiwan industries that have high levels of Mainland trade and investment, especially the cement, petrochemical and steel industries, are more strongly influenced by changes in the PRC economy.

Aviation Issues -Direct Links, ICAO, Cargo 7ths

12. (U) The lack of direct aviation links between Taiwan and the PRC is the primary concern of Taiwan's aviation industry and the largest remaining obstacle to deeper economic relations across the Strait. In February 2003 during the Lunar New Year, Taiwan airlines were permitted to conduct charter flights between Taipei and Shanghai with stops in Hong Kong. The Chen government has indicated that it wants to negotiate direct charter flights in 2005 for both Taiwan and PRC carriers with no stopovers as the next step toward regular direct aviation links (reported refuels). On both sides of the Strait this is a highly charged political issue. To date, the PRC government has not accepted Chen's invitation to negotiate charter flights, insisting that Taiwan first accept the "one-China" principle and its corollary that cross-Strait flights would be "domestic."

13. (U) Taiwan seeks to join the International Civil Aviation Organization (ICAO) as a full member or observer. Because it is not a sovereign state, Taiwan is excluded from such UN organizations and many other international organizations. Entry into organizations such as ICAO and the World Health Organization that focus on economic and health issues has been a key priority of Taiwan's foreign policy. The U.S. supports Taiwan's efforts to gain increased access to ICAO discussions and technical information to improve its flight safety efforts.

14. (U) In 2003, AIT urged Taiwan to add "seventh freedom" rights for all-cargo services to our bilateral open skies agreement and to join the Multilateral Agreement on Liberalization of International Air Transportation, which includes cargo sevenths. The Taiwan government rejected both proposals. Taiwan's carriers rely heavily on cargo shipments to make them profitable and support continued restrictions of international participation in Taiwan's cargo routes. Taiwan's recently concluded bilateral air services agreement with South Korea excludes cargo fifth freedom rights. Taiwan and South Korea signed the new agreement on September 1 after a dozen years without direct air links.

PAAL